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Fables and Fundamentals: A Note on Indian Equities

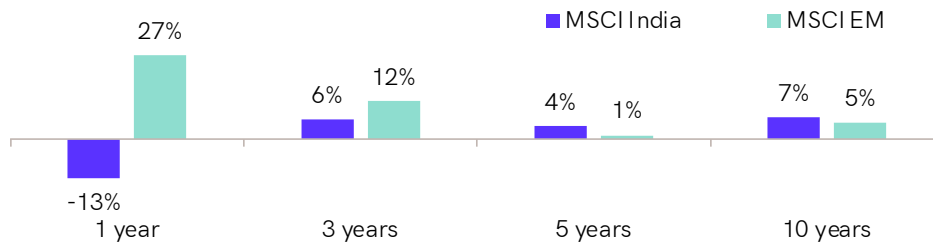
The Long View, and the Short One

What's the right period to look back on when judging an asset class — one year, three years, or five? The question matters more than it seems, and it's worth thinking through before any fair evaluation can begin. Importantly, this window should be decided upfront. Choosing it after the fact opens the door to bias, as we end up picking the timeframe that tells the story we already want to tell.

To prevent this bias, let's look at the comparative performance of Indian equities across different time periods –

Chart 1:

Annualized Index Returns (USD)

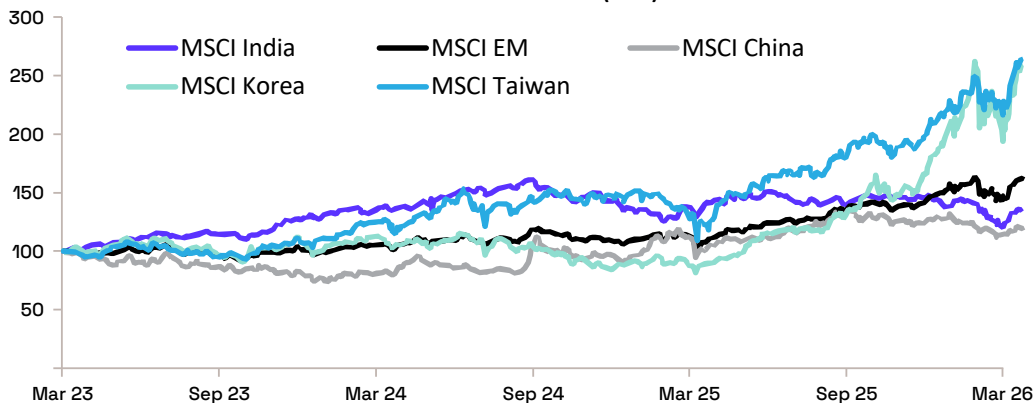


Source: Bloomberg, 360 ONE Asset Research
Note: Returns are calculated as of 31st March 2026.

The long-term picture is clear: Indian equities have outpaced the broader emerging markets (EM) index. But zoom into the last three years, and the story flips: India has underperformed the EM index. And that EM outperformance appears to be driven largely by just two markets: Korea and Taiwan (Chart 2). Two markets, as it happens, that sit right at the heart of the Gen-AI boom — more on that in a bit.

Chart 2:

Market Performance (USD)

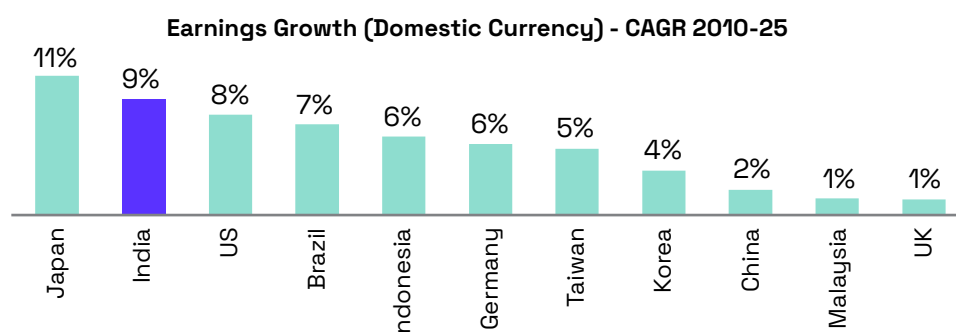


Source: Bloomberg, 360 ONE Asset Research

The Earnings Picture

Markets, as the adage goes, are slaves to earnings. With that in mind, let's also look at how India's earnings growth compares to a broader set of emerging (EM) and developed markets (DM).

Chart 3:

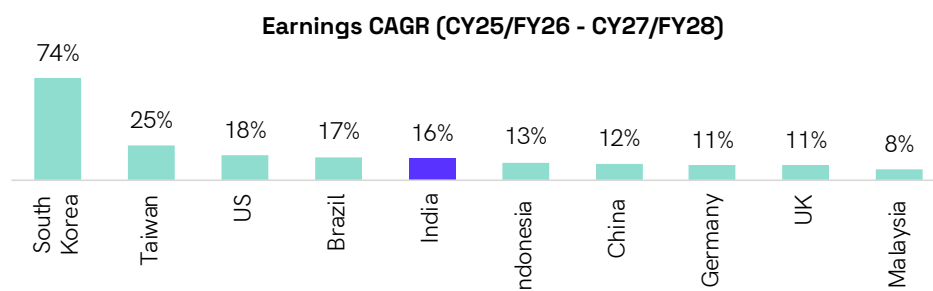


Source: Yes Securities, 360 ONE Asset Research

Note: For India, earnings growth is calculated on a fiscal-year basis from FY11 to FY26, with FY26 as an estimate.

Over the past 15 years, India has clearly delivered on earnings growth, outpacing most EM and DM markets, with Japan being the lone exception. In fact, Taiwan and Korea have grown earnings at just 4-5%, well short of India's 9%. But flip the lens to forward earnings expectations, and the picture changes sharply. South Korea suddenly appears to be operating on an entirely different scale, with forward earnings growth expectations of 74%. Taiwan, at 25%, is also well ahead of India's 16%. The catch, though, is that these forecasts are almost entirely a bet on Gen-AI. And if the AI story doesn't live up to the hype, these earnings numbers are the first casualty.

Chart 4:

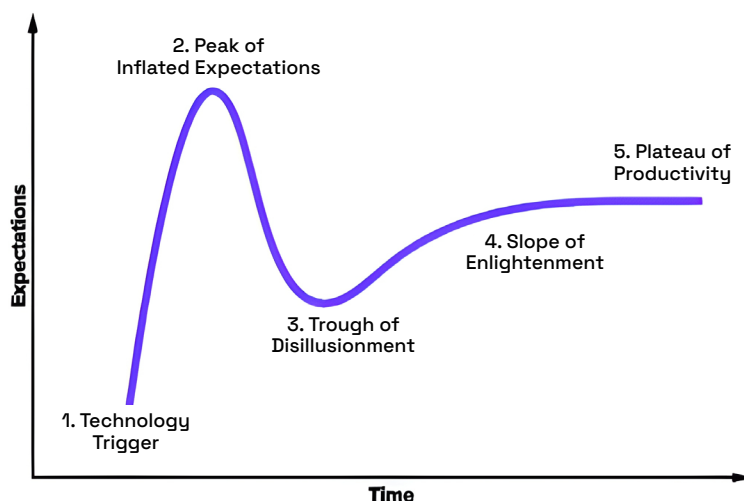


Source: CLSA

To understand why that's a real risk, it helps to take a brief detour into the Gartner Hype Cycle.

Chart 5:

Gartner Hype Cycle



AI: Promise vs Hype

The Gartner Hype Cycle is a framework showing how new technologies mature over time, moving through five stages: a Technology Trigger sparks interest, a Peak of Inflated Expectations brings overblown hype, a Trough of Disillusionment sets in as reality disappoints, a Slope of Enlightenment emerges as practical uses take shape, and finally a Plateau of Productivity is reached when the technology delivers mainstream value.

The dot-com boom famously traced this curve — peaking in the late 1990s, crashing in 2000, and recovering as the web matured into everyday infrastructure.

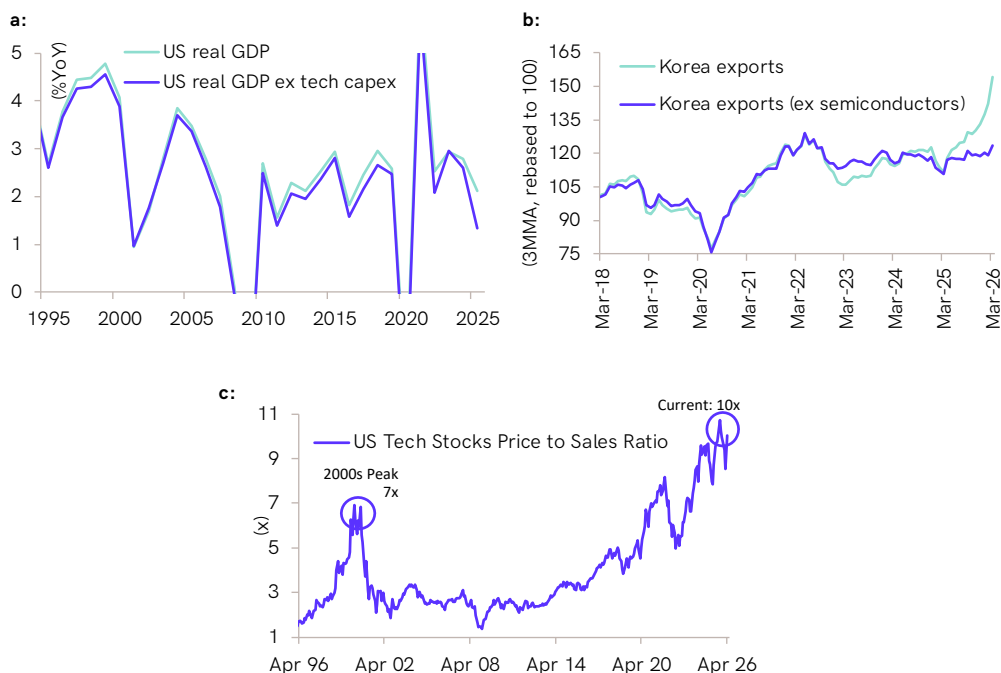
The obvious question, then, is this: where does Gen-AI sit on this curve right now?

Let's answer that straight away. We don't know. AI could be closer to the Technology Trigger, it could be at the Peak of Inflated Expectations, or somewhere in between. What we do know is this: it hasn't yet passed through the Trough of Disillusionment. And therein lies the risk.

Three data points below help quantify just how much of today's growth story is riding on AI:

1. US real GDP is being propped up by AI-related capex. Strip that out, and the underlying economy looks notably weak. (Chart 6 a)
2. Korea's exports are holding up largely on the back of AI capex. Ex-semiconductors, the picture is far less flattering. (Chart 6 b)
3. US tech stock valuations are at 10x price-to-sales, meaningfully above even the 2000 dot-com peak of 7x. (Chart 6 c)

Chart 6:

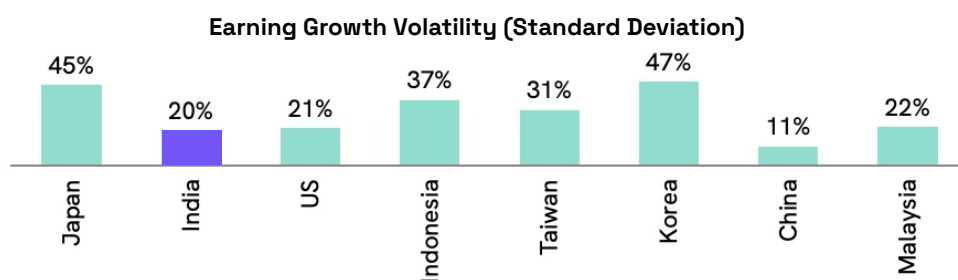


Source: Nuvama Institutional Equities

To be clear, we strongly believe AI is a general-purpose technology with the potential to significantly boost productivity, reshape entire industries, and unlock value in ways we are only beginning to imagine. But none of that prevented the internet from going through its own bubble and bust in 2000, even though the technology itself went on to become the backbone of modern life. If anything, the dot-com episode is a reminder that transformative technologies and speculative bubbles are not mutually exclusive. They can go hand in hand. Given the nature of markets and of human behaviour more broadly, we believe AI is likely to travel the same path.

And this is where India offers resilience, with its more measured exposure to AI. Indian earnings growth has historically been far less volatile than that of most other key markets, and we expect that to hold, supported by a well-diversified sector mix and lower reliance on the global cycle.

Chart 7:



Source: Yes Securities, 360 ONE Asset Research

To be clear, this is not a pitch for India as an anti-AI play. We push back firmly on that framing, because it isn't true. India is very much part of the AI value chain. The point is simply that Indian earnings are likely to ride out the AI hype cycle with less turbulence.

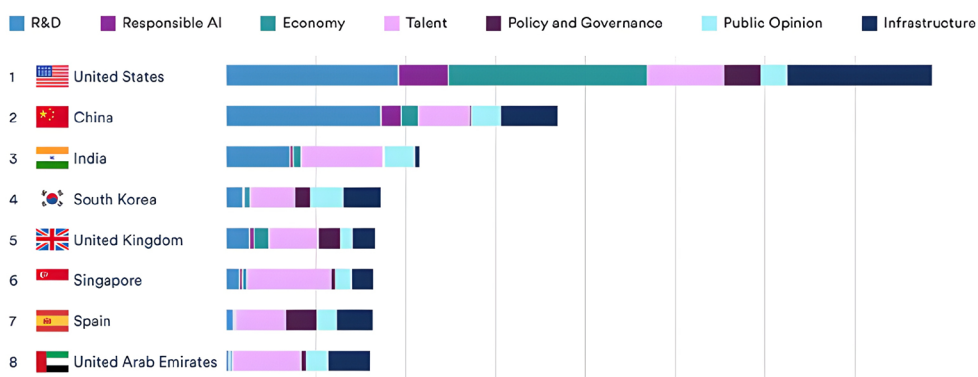
Which makes this a good moment to turn to the next question: What exactly is India's role in the AI value chain?

Not an Anti-AI Play

Let's start with an interesting statistic. According to Stanford University's Global AI Vibrancy Index, India is now the world's third-most-vibrant AI ecosystem, trailing only the United States and China. More strikingly, India has climbed four spots in just a year, from 7th in 2023 to 3rd in 2024.

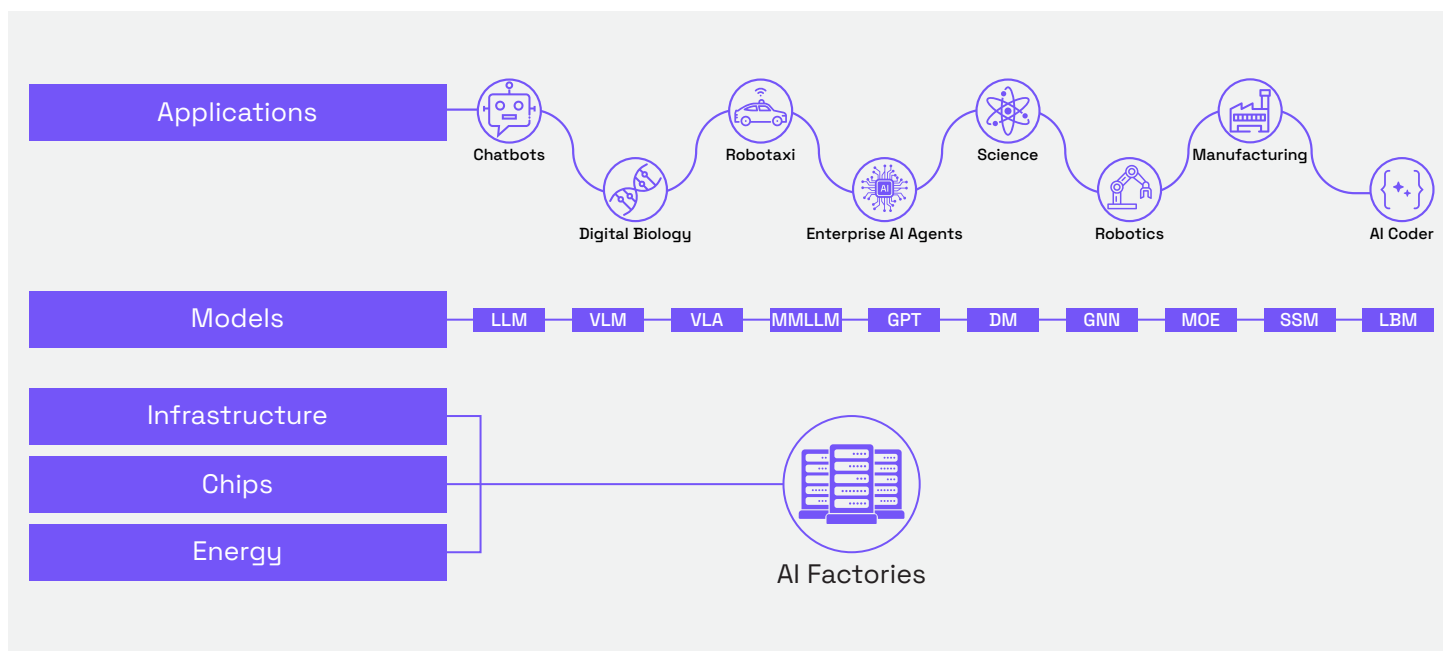
Chart 8: 2024 Global AI Vibrancy Ranking (Absolute)

Weighted Index Score | Source: 2026 AI Index



Source: Stanford University

Now, let's analyse India's AI stack through Jensen Huang's "Five-Layer AI Cake" model:



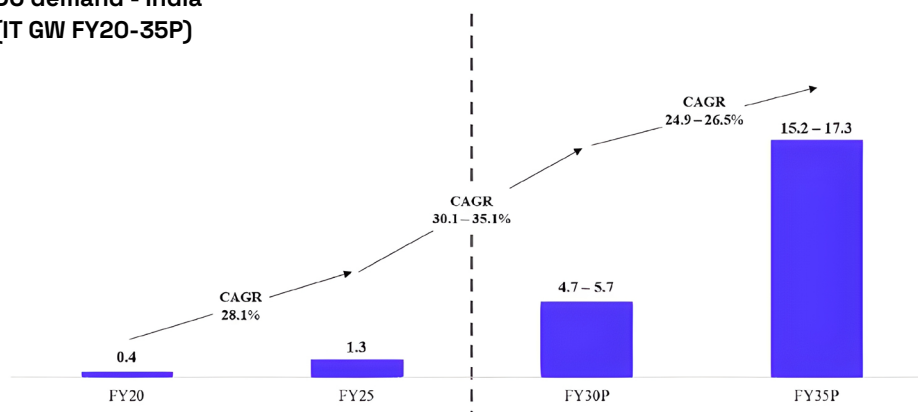
Source: <https://blogs.nvidia.com/blog/ai-5-layer-cake/>

India shows up across most layers of the AI stack. But the real momentum sits in **infrastructure**, data centres in particular, and the **energy** capacity needed to run them.

The numbers make the case. India generates close to 20 per cent of the world’s data, yet accounts for just 3 per cent of global data centre capacity¹. That gap is both the opportunity and the imperative.

The build-out is already well underway. Installed DC capacity has grown from around 375 MW in 2020 to roughly 1.5 GW in 2025², and is projected to reach 5-6 GW by 2030 and 15-17 GW by 2035. The government is backing the push, with incentives including a tax holiday until 2047 for companies building data centre infrastructure in the country.

Chart 9: DC demand - India (IT GW FY20-35P)



Source: ¹Lattice analysis, SIFY DRHP

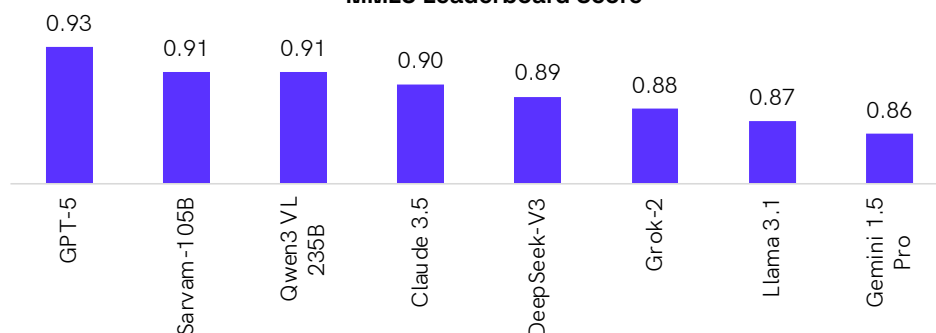
This scale of data centre build-out will trigger a parallel wave of investment in energy infrastructure, particularly renewable energy. India has already installed 283.46 GW of non-fossil fuel capacity as of 31 March 2026, and the government is targeting 500 GW by 2030³.

Beyond headline generation capacity, expect meaningful capex across the rest of the chain as well. Captive power plants to directly serve data centres, large-scale transmission upgrades to connect renewable-rich regions to demand hubs, and investments in battery storage and grid modernisation will all be part of the mix.

The AI story, in that sense, is as much an energy story as it is a compute story.

The government has also thrown its weight behind the development of India’s AI ecosystem, with the IndiaAI Mission at its centre. Under the mission, twelve teams have been shortlisted to develop indigenous foundational models, or Large Language Models, at the **model layer** of the stack. One of them, Sarvam AI, finished second only to OpenAI on the Massive Multitask Language Understanding (MMLU) Leaderboard. The mission is also addressing the compute bottleneck head-on, with more than 38,000 GPUs⁴ onboarded for a common compute facility, available to Indian startups and academia at affordable rates.

Chart 10: MMLU Leaderboard Score



Source: IIm-stats (April 2026)

Note: Massive Multitask Language Understanding benchmark testing knowledge across 57 diverse subjects, including STEM, humanities, social sciences, and professional domains

¹Deloitte

²PIB

³PIB

⁴PIB

Beyond infrastructure and models, though, India’s AI story is increasingly being written at the **application layer**. The focus here is squarely on solving real-world problems, whether through tuberculosis screening via cough audio analysis, cervical cancer detection, crop yield prediction, payment fraud detection, multilingual government services, or defence applications. A wave of startups has emerged in this space, most of them taking an application-first approach rather than a model-first one.

India, admittedly, does not have a pure-play AI champion in the way that frontier model builders (US), semiconductor companies (Taiwan), and DRAM chipmakers (Korea) do. But that is only part of the story. AI models need data centres to run on, and those data centres need energy, ideally renewable. The productivity promise of AI will only materialise when models are embedded in real-world applications. And to be genuinely useful at scale, these models need to understand local context, languages, culture, and user behaviour. In each of these layers, India is making its presence felt.

But there’s one part of the AI conversation in India that we’ve deliberately set aside until now, the impact on Indian IT services. That’s the elephant in the room, and it deserves its own examination.

The IT Services Question

The market is pricing in a deep structural shift in how IT services operate. AI is helping vendors reduce internal costs by boosting productivity, but clients are now demanding that those savings be passed on as lower contract prices. The industry has a term for this: AI-led deflation, where the same scope of work gets delivered for steadily shrinking revenue.

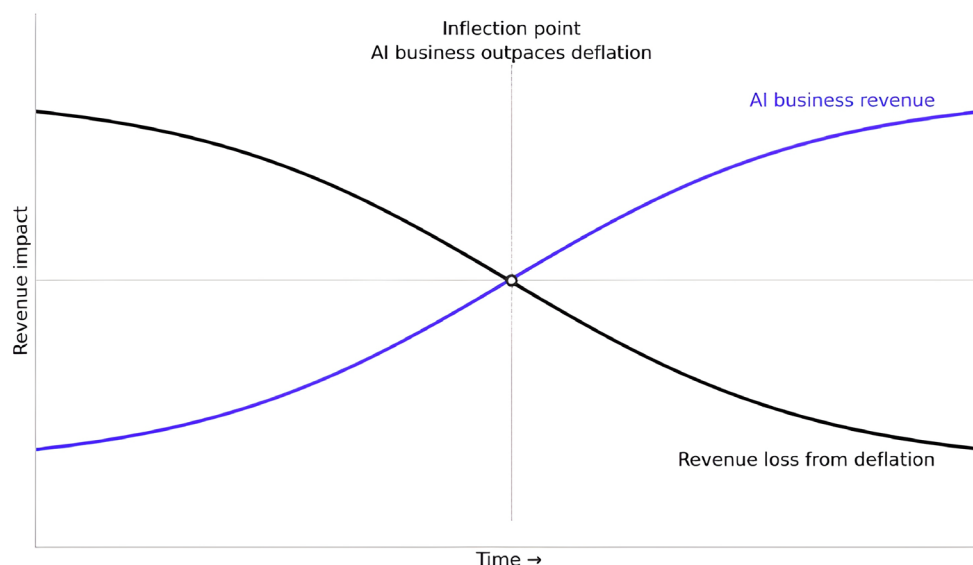
The pressure is sharpest in the legacy service lines most exposed to automation - manual testing, L1 support, basic coding, data labelling, and traditional ADM. These still make up a meaningful share of the revenue mix, which is why the near-term drag on reported numbers looks set to persist.

But deflation is only one side of the equation. AI is also opening up entirely new revenue pools. Application modernisation, data engineering, AI agent orchestration, prompt engineering, AI-assisted QA, and enterprise integration are all scaling rapidly as companies move from pilots to full-scale deployment.

The two forces shaping the sector can be thought of as two curves moving in opposite directions. The deflation curve starts high, reflecting the steep revenue loss from legacy service compression that dominates today, and slopes downward over time as the pace of displacement eases. There is, after all, only so much that legacy service lines can shrink. The AI revenue curve, in contrast, starts low because AI services are still in their early innings and slopes upward as enterprise deployments scale from pilots to production.

The point where these two curves cross is the inflexion point. Before the crossover, the drag from deflation outweighs the lift from new AI revenue. Reported growth disappoints, and sentiment stays weak. After it, the equation flips. The lift starts outpacing the drag, growth accelerates, and the stage is set for a sector-wide re-rating.

Chart 11:



Underlying both forces is a deeper structural shift in the commercial model itself. The industry is moving from a labour-intensive model, where firms charge per person-hour and revenue scales with headcount, to a results-oriented model that decouples revenue from effort.

And here is where it gets interesting. The economics now hinge entirely on who captures the AI productivity gain. Vendors that pass the savings on to clients will watch contract values compress and margins erode. Vendors that retain the productivity dividend, by packaging ‘services as software’, moving to outcome-based pricing, and breaking the link between headcount and revenue, could see margins expand even as contract sizes shrink.

That said, two genuine uncertainties remain. The first is timing, when exactly the inflexion point arrives. The second, and arguably the more consequential, is distribution, who ultimately captures the AI productivity dividend, vendors or their clients. The answer to that determines whether the post-inflexion phase delivers revenue growth alone or revenue growth alongside margin expansion.

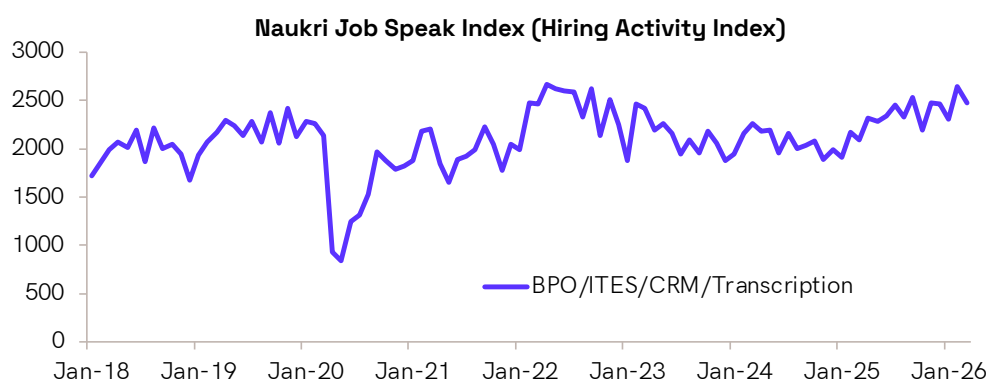
On balance, we remain optimistic that Indian IT services firms will be net beneficiaries of the AI adoption. Their deep domain expertise, embedded client relationships, and scaled delivery infrastructure give them the right to win the orchestration layer of enterprise AI. This work translates foundation models into running business outcomes.

But this is not a rising tide that will lift every boat. Firms that refuse to disrupt their own operating models, cling to FTE-based billing, and treat AI as a tool rather than a business-model transition will likely fall behind. At best, they will end up relegated to commoditised, price-compressed service lines. The AI cycle, in that sense, will be kinder to the industry than feared, but far less forgiving of the laggards within it.

One last point before we move on, and it is a counterintuitive one. India’s BPO sector, the part of ITES most expected to be hollowed out by AI, is doing remarkably well.

On paper, BPO should be ground zero for AI-led disruption. The work is repetitive, process-driven, and exactly the kind that AI is supposed to displace first. And yet, the early signs (and we will caveat that it is still early) point the other way. The business is doing well. Hiring is strong. Firms are leaning into AI rather than being eaten by it.

Chart 12:



Source: CMIE, 360 ONE Asset Research

WHY?
JEVONS PARADOX.

AI-driven productivity gains are reducing delivery costs. BPO firms are embedding AI into their workflows and passing those gains back to clients. In return, clients are outsourcing more, especially non-core functions like financial management, HR, and supply chain. Lower unit costs are expanding the very scope of what makes economic sense to outsource.

Which raises the obvious question. Could broader IT services follow the same arc?

Only time will tell. But the BPO experience is, at the very least, a useful counterpoint to the doom narrative.

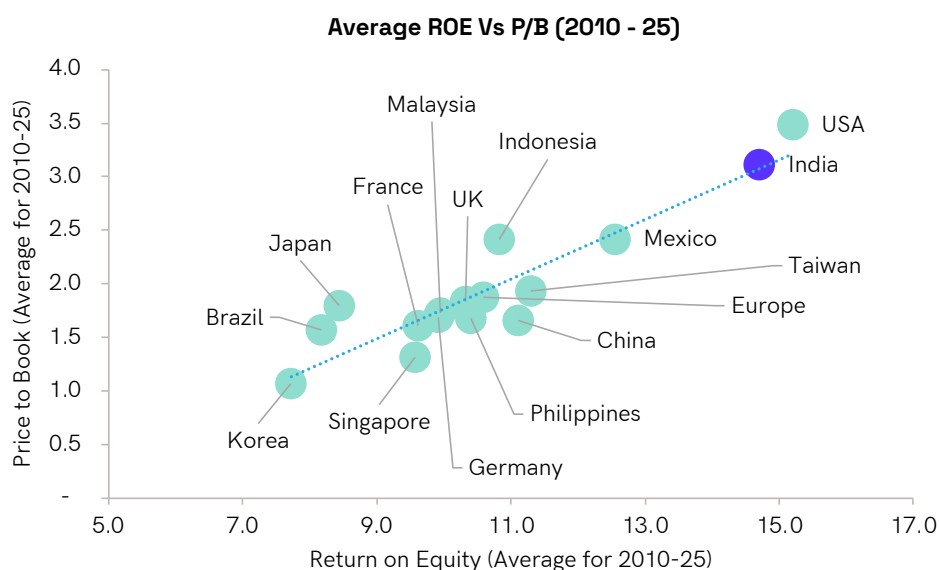
Beyond the AI debate, every investment story eventually circles back to two anchors: the return a business earns on its capital, and the price an investor pays to own it. In other words, Return on Equity (RoE) and valuations. Let's turn to both.

The Price You Pay

There are two useful ways to look at valuations: relative to other markets, and relative to a market's own history.

Start with the first. Indian equities have, for the most part, traded at a premium to other markets. And our position has consistently been that these higher valuations are justified by the higher ROEs that the Indian market delivers. The data backs this up. If you plot long-term ROEs of different markets on one axis and valuations on the other, India sits right on the trend line. Its premium is, quite simply, earned.

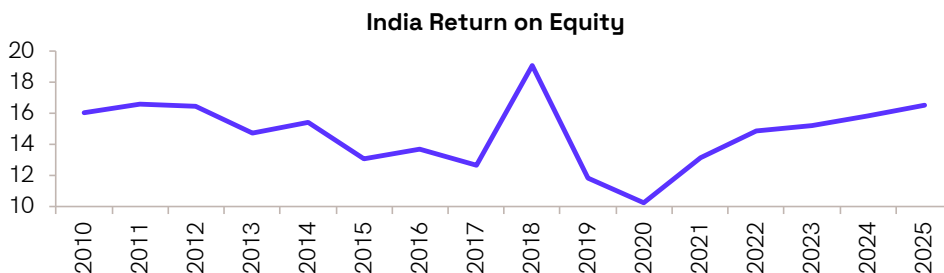
Chart 13:



Source: Yes Securities, 360 ONE Asset Research

India's ROE story has, if anything, only got better. After bottoming out in 2020, it has been on a steady climb ever since. What makes this especially encouraging is that corporates have delivered these higher ROEs while deleveraging their balance sheets. As capex picks up and companies start putting that balance sheet headroom to work, ROEs could see a further leg up.

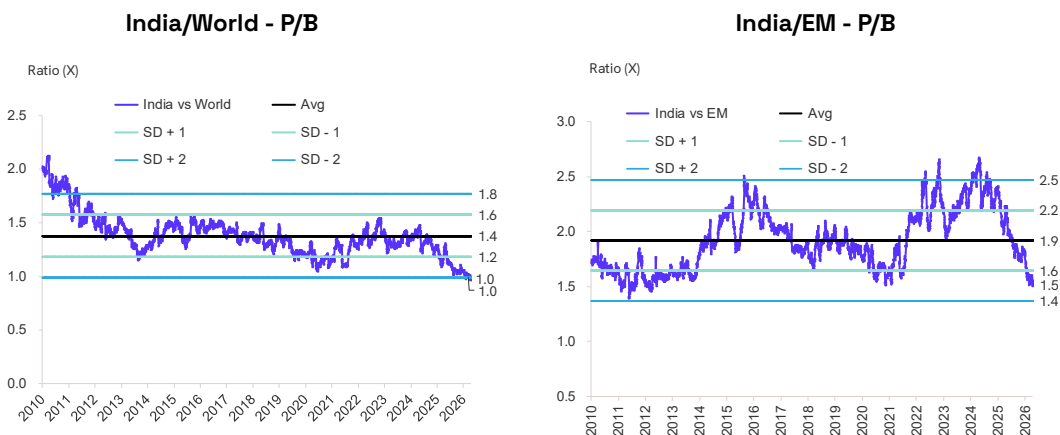
Chart 14:



Source: Yes Securities, 360 ONE Asset Research

And here is where the story gets interesting. Even as the ROE story has gotten stronger, India's valuation premium over world and EM peers has compressed sharply, and is now substantially lower than it has been historically. Stronger fundamentals at a narrower premium is a combination worth paying attention to.

Chart 15:

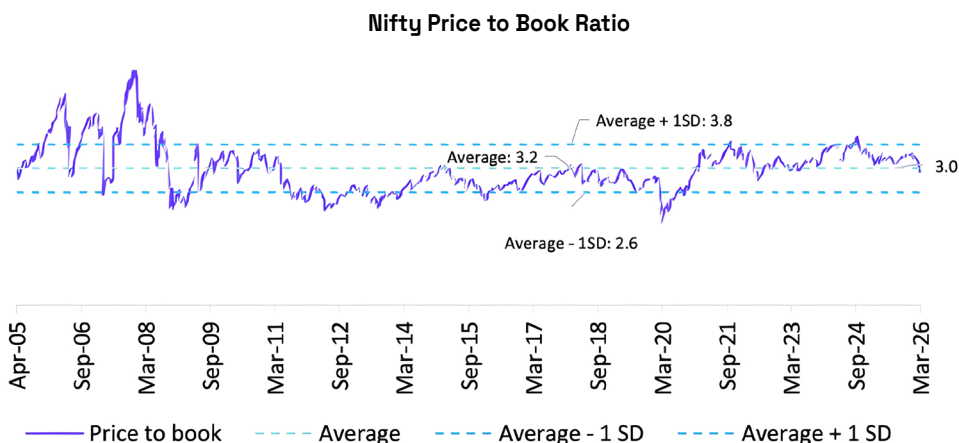


Source: Yes Securities, 360 ONE Asset Research

Now to the second lens, valuations relative to a market's own history. Nifty's price-to-book ratio peaked near 1 standard deviation above its long-term average in September 2024 and has since drifted lower as markets have largely remained range-bound. Today, the ratio sits marginally below the 20-year average.

In other words, the froth that had built up has quietly worked itself off. Indian valuations are no longer expensive relative to history.

Chart 16:

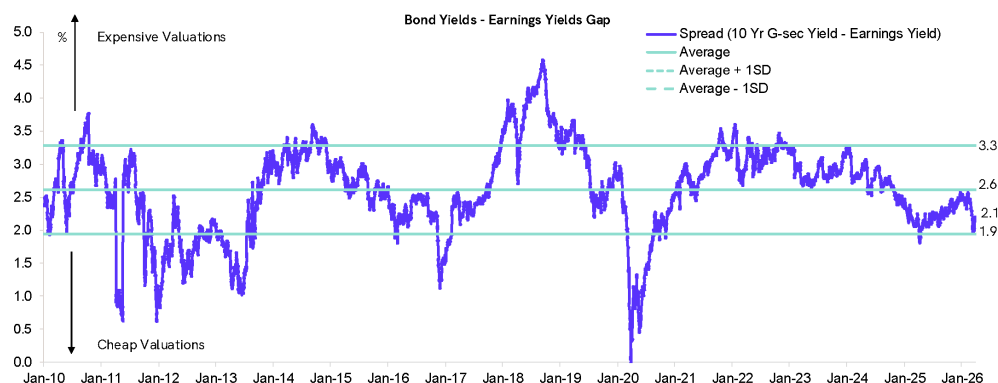


Source: Bloomberg, 360 ONE Asset Research

The bond-relative picture is even more striking. The gap between bond yields and earnings yields is now at roughly 1 standard deviation below its long-term average. This is worth pausing on. On a standalone basis, Indian valuations are no longer expensive. Relative to bond yields, they look even more favourable.

Chart 17:

Bond Yields - Earnings Yields Gap



Source: Bloomberg, 360 ONE Asset Research

The Rupee Story

No discussion on returns is complete without bringing the Indian rupee into the picture. And we'll admit up front that the rupee's depreciation over the past year has been sharper than we expected. Our focus had been on the macro fundamentals - strong economic growth, low inflation, and a stable current account, none of which, on their own, justified the kind of move we have seen in the currency.

The real pressure, as it turns out, was building elsewhere, on the capital account. And the story there ties straight back to two themes we have already discussed: valuations and AI.

Table 1:

	USD Bn	FY22	FY23	FY24	FY25	FY26
A = a - b	Foreign Direct Investment to India*	56	42	27	29	37
a	Gross Inflows	85	71	71	81	88
b	Repatriation/Disinvestment	29	29	44	51	51
B	Foreign Direct Investment by India*	18	14	17	28	31
C = A - B	Net Foreign Direct Investment	39	28	10	1	6
D	Net Portfolio Investment**	-17	-5	44	4	-16
of which,	Equity	-16	-6	25	-16	-19
	Debt	2	1	19	19	3
C+D	Foreign Investment Inflows	22	23	54	5	-10

Source: CMIE, 360 ONE Asset Research

Note: *FY26 Foreign Direct Investment data is available up to February 2026; **Portfolio Investment data is estimated up to March 2026.

Net foreign inflows have collapsed over the past two years, swinging into negative territory in FY26, driven by two forces.

The first is Foreign Direct Investment (FDI) repatriation. Gross FDI inflows have held up reasonably well, but exits have stepped up sharply. Elevated valuations from 2023 to 2025 gave foreign investors a good opportunity to book profits.

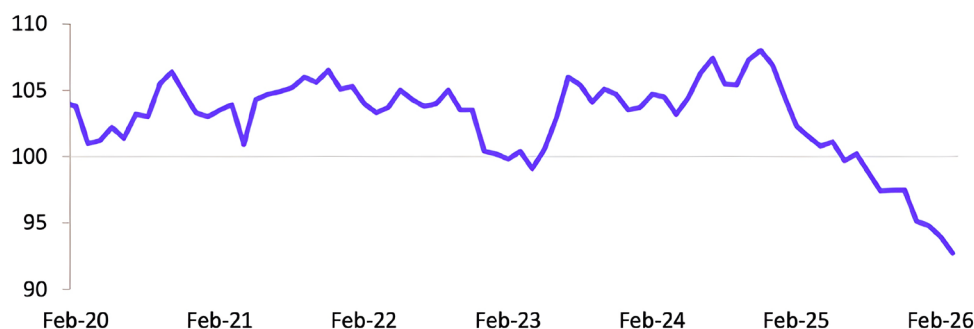
The second is Foreign Portfolio Investor (FPI) equity outflows. After a strong showing in FY24, foreign portfolio investors have been steady sellers through FY25 and FY26. The driver here is a familiar mix, stretched valuations, the absence of a pure-play AI bet on India, and a perception (mistaken, in our view) that India is sitting out the global AI value chain.

The encouraging part is that both pressures should ease from here. Valuations have corrected, both relative to history and relative to peers. And as we have argued earlier, Indian earnings, except IT services, are fairly insulated from AI-led volatility. As global investors reassess the picture, the relative-value case for India should start to attract flows again.

One last point worth flagging. Outbound FDI by Indian companies has been steadily rising, with Indian corporates increasingly going global. That, frankly, is a development worth celebrating, not complaining about.

Taken together, we expect the depreciation pressure on the rupee to subside. The Real Effective Exchange Rate (REER) reinforces that view. With REER now significantly below 100, the rupee is, by this measure, undervalued. Like any valuation metric, REER doesn't rule out further weakness. What it does offer is a margin of safety, much like cheap equity valuations don't guarantee a rally, but they do narrow the room for further pain. All of this is to say that the rupee is unlikely to remain a headwind to overall returns as it has been over the past year.

Chart 18: INR Real Effective Exchange Rate (REER) - Trade Weighted 40-Currency Basket (Base: 2015 -16=100)



Source: CMIE, 360 ONE Asset Research

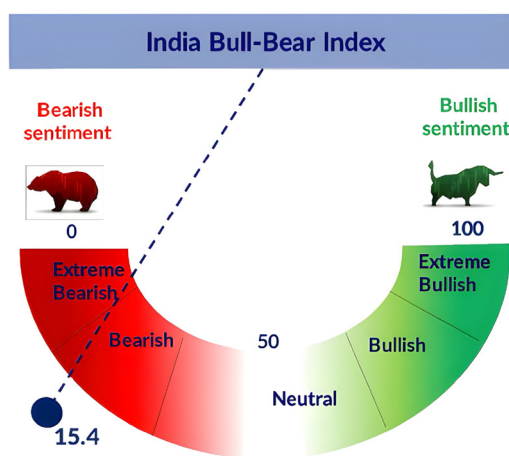
The Bottom Line

In this note, we have walked through most of what matters: returns, past earnings, forward expectations, AI, IT services, valuations, the rupee, and capital flows. The conclusion is, we suspect, already obvious. We remain constructive on Indian equities.

Cycles are an unavoidable part of investing. For any long-term investor, the real edge lies in looking through them and staying focused on a market's ability to deliver over the long haul. India has done that historically, and we believe it is well-positioned to keep doing so.

Before we sign off, we will leave you with two charts worth dwelling on. One captures the mood of the market today. The other, where India's growth potential sits relative to the rest of the world.

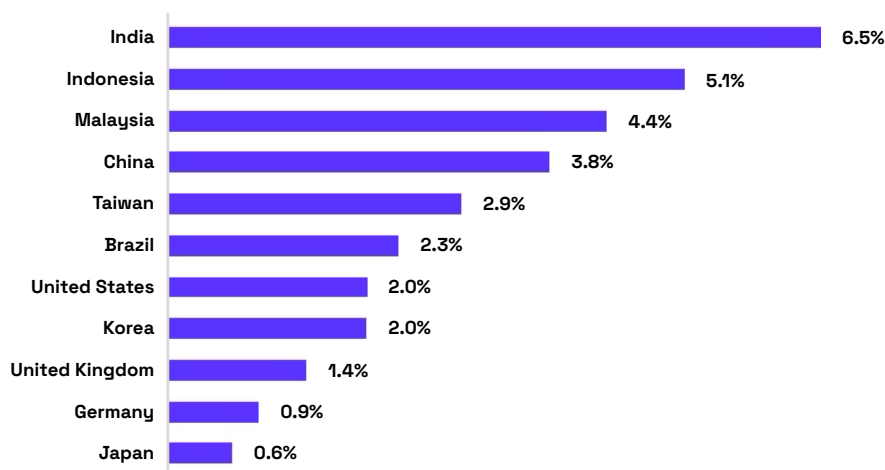
Chart 19:



Source: CLSA (April 2026)

Chart 20:

Real GDP Growth Projection CAGR 2025-2031



Source: IMF WEO April 2026



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